



July 14, 2022

Shirley Ford
Chief Financial Officer
City of Memphis, TN

Re: Memphis Center City Revenue Finance Corporation One Beale Project

Dear Chief Ford



530 Oak Court Drive
Suite 160
Memphis, TN 38117
901.682.8356

pfm.com

Per our discussions this week, we understand that City Council is being asked to consider a Resolution tomorrow to further support (financially) the One Beale Street/Grand Hyatt Development. The Resolution contemplates that the Development will be funded, in part, with bonds to be issued by the CCRFC. The City has previously committed to a 50% guarantee of debt service. In March, PFM and the State were asked to opinion on this guaranteed level and while not ideal we conceded to the overall business case for downtown and the newly renovated convention center.

At 50%, the City's exposure is estimated at approximately \$3.5 million per year, or a total of \$80 million over the next 30 years¹. The City has now been asked to double the guarantee to 100% of the debt service, increasing the exposure up to approximately \$7 million annually, or a total of \$161 million over 30 years. For consideration if the 50% commitment (or \$3.5 million) was needed in the future, that would equate to \$0.025 on the property tax bill and at 100% (or \$7.0 million), would equate to an additional \$0.05 of property taxes.

PFM has performed a very preliminary review of certain bond documents, revenue projections and other limited information provided by the developer team. If the City agrees to a 100% debt service guarantee, PFM has identified the following risks and concerns for the City to consider:

- **Reduction of Debt Capacity**– We understand the City to have a number of capital projects in the planning stage. Use of the non ad-valorem revenue pledge for debt is limited. Any application of this pledge will reduce available capacity for future projects.
- **Downward pressure on the City's credit rating** – while, according to the developer, the debt is intended to be self-supporting and the guarantee is not expected to be called upon, the rating agencies will view this as non self-supporting debt in consideration of their rating analysis. Any negative impact to the rating will result in a higher cost of capital for the City. We understand

¹ Per Wells Fargo estimates as of July 11, 2022



that there has not been a presentation to the rating agencies, so they have not had an opportunity to provide an analysis to the impact of the City's credit rating.

- **Interest Rate Volatility Risk**– While the total estimated debt service exposure is approximated to equal to \$161 million based upon current market conditions, if interest rates rise, this could increase the City's exposure.
- **Weak Financial Debt Service Coverage** As presented, the current financing reflects a debt service coverage ratio of 1.30X. In similar transactions with the City for which PFM served as the Co-Financial Advisor, the debt service coverage ratio was 2.0X of future debt service payments compared to projected revenues.
- **Uncertain Terms of the Development Agreement** • We understand the Developer Agreement is not complete and have requested confirmation of this information, assuming incomplete we raise the following areas for the City to consider and where the City has a vested interest.
 - The terms of how the risks of the Development are to be shared amongst the parties involved are incomplete, undisclosed and subject to further negotiation.
 - The terms regarding the use of excess revenues and how profits are to be shared are also incomplete.

Given the City's guarantee support at any level, the City should be fully invested in the negotiations with the Developer on the flow of funds and the timing of access to accumulated revenues in order to protect the City's operating dollars.

- **Increasing Costs of Capital for the City** – The developer cites increasing interest rates and market volatility to drive the request for the additional City guarantee. The City is subject to these same market dynamics and will be subject to increased costs of capital for future borrowings. Absent this transaction, the City is already facing near-term pressure on their debt capacity.
- **Outside stakeholder relations** - The broad consideration of the Development as currently structured should consider outside stakeholder relations:
 - Other hotel developers have looked to the City for financial support and the City has opted not to lend their credit. If the City proceeds with this transaction, other private parties will look for support, as well.



- The State has publicly voiced their concern for this project and their lack of support.
- **Market (Feasibility) Study** – The intent is for the bonds to be self-supporting and require a market (feasibility) study to demonstrate some level of assurance that outcome is achievable. While PFM did not have enough time to dig into all the details, we did notice a few areas the City should consider that were included (or not included) in the market study:
 - Stress testing – the market study did not include any level of stress testing or a downward turn in hotel traveler trends, like what was recently experienced in 2020 due to the pandemic.
 - Increased hotel supply – the market study indicates hotel room supply will increase by ~ 84% from 2019 to 2025 while market occupancy remained consistent from 2019 at ~ 77%. This assumption only further emphasizes the need for a stress test given the expected additional hotel supply.

We offer these observations based upon an expedited consideration of the limited materials provided to us over the last 48 hours. We are not representing to be the Financial Advisor to this transaction and not offering any financial advice to the City or any other related party as to whether this development should proceed or whether bonds should be issued. To serve in a financial advisory capacity, we would need to obtain and review more information to determine if it is suitable for the City of Memphis.

We also understand the City may opt to modify its support of this project in other ways but in doing so should consider the factors outlined herein in an effort to minimize the risk to the City.

We appreciate the opportunity to be of service and look forward to continue working with the City.

Sincerely,

PFM Financial Advisors LLC

Lauren S. Lowe



Managing Director